Answers

Marks

1 (a) (i) Company H

		Marks
(1)	The IIT borne by the company is for a business purpose and is tax allowable.	1
(2)	As the tax period only covers six months of the rental period, RMB750,000 (18/24 x 1,000,000) is disallowable.	1·5
(3)	Subject to the maximum amount of 0·5% of the sales income of the year (180,000,000 x 0·5% = 900,000), 60% of the entertaining amount (1,800,000 x 60% = 1,080,000) is deductible. Thus, RMB900,000 is deductible and RMB900,000 (1,800,000 – 900,000) is non-deductible.	2
(4)	Advertising and promotion expenses are deductible up to 15% of the sales/business income of the year; thus the entire amount of RMB600,000 is deductible.	1·5
(5)	Amortisation of a self-developed intangible asset is not allowable.	1
(6)	Unused assets should not enjoy tax depreciation.	1
(7)	Depreciation of assets purchased under a finance lease is allowable.	1
(8)	Depreciation of assets rented under an operating lease is not allowable.	1
(9)	A penalty imposed by the government is not allowable.	1
(10)	A penalty arising from the business' operations is allowable.	1
(11)	A general provision is not allowable.	1
(12)	Interest income from a national debenture is exempt.	1
(13)	A gain on the disposal of a national debenture is taxable.	1
(14)	A loss on the trading of listed shares is allowable.	1
(15)	The share of a loss of an associated company under the equity method of accounting is not allowable.	1
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(ii) Enterprise income tax computation for the year 2009:

			RMB	RMB	
Taxable profit before adjustment				44,540,000	0·5
Add:					
	(2)	Office rental expense	750,000		0·5
	(3)	Entertaining expense	900,000		0·5
	(5)	Intangible asset amortisation	300,000		0·5
	(6)	Un-used asset depreciation	200,000		0·5
	(8)	Depreciation on rented assets	50,000		0·5
	(9)	Penalty for late filing of annual return	100,000		0·5
	(11)	Stock loss provision	200,000		0·5
	(15)	Share of loss of associated company	400,000		0·5
Less:					
	(12)	National debenture interest	(40,000)		0·5
		Total adjustment		2,860,000	
		Adjusted profits		47,400,000	
Less:	Losses brought forward			(10,000,000)	1·0
	Taxable profit			37,400,000	
					6

(iii) As Company H was incorporated before 16 March 2007, it can benefit from the transitional arrangement i.e. it is deemed to start to enjoy the exemption year in both of 2008 and 2009. Hence the EIT payable for 2009 will be zero. 2

(b) (i) (1) The term 'fixed assets' refers to assets with a useful life of more than 12 months used for the purposes of producing goods, the provision of services, etc, including buildings, structures, machinery, transportation and other equipment. 1·5

Tax depreciation is allowable on a straight-line basis beginning from the month following that in which the fixed asset is placed into use. Where an asset ceases to be used, depreciation shall not be calculated beginning from the month following that in which the use of the fixed asset ceases. 2·0

Minimum depreciation periods are specified for certain types of fixed asset, from three to 20 years. 0·5

4

Marks

(2) Research and development expenses are expenses incurred for the development of new technologies, new products or new production techniques. 1

Research and developing expenses charged to the income statement are given an additional 50% deduction on top of the actual expenses incurred as tax allowable. For research and development expenses capitalised as intangible assets, the cost base of the intangible asset equals 150% of the actual expenses for tax amortisation purposes. 2

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(ii) (1) If the repairing expenditure satisfies both of the following conditions, it can be treated as a long-term deferred asset and the expenditure can be depreciated over the remaining life of the asset:

– the expenditure is more than 50% of the original tax cost of the asset; and
– the asset can be used for more than two years after repairing. 2

(2) The wages paid to an approved disabled employee are granted a 100% additional deduction on top of the actual expense incurred for tax deduction purposes. 1

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2 (a) Mr Gu – Individual income tax

(i) Company F:

Tax withheld from Mr Gu's basic salary plus position bonus before secondment: (with monthly deduction):
[(5,000 + 6,000 – 1,600) x 20% – 375] x 2 = 3,010 1
Basic salary income after secondment, tax withheld (no monthly deduction):
(5,000 x 15% – 125) x 10 = 6,250 1
Tax withheld from annual bonus: 120,000 ÷ 12 = 10,000
Where the applicable tax rate is 20% and quick formula deduction is 375
Tax thereon: 120,000 x 20% – 375 = 23,625 2

Company S:

Tax withheld (with monthly deduction) from subsidy:
[(13,000 – 2,000) x 20% – 375] x 10 = 18,250 1

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(ii) Because Mr Gu has received employment income from more than one source in 2008, he will have been required to file his own tax return with the tax authorities and pay additional tax directly as follows: 1

January to February: IIT = 3,010 *(as in (i) above)*
March to December monthly payment: [(5,000 + 13,000 – 2,000) x 20% – 375] x 10 = 28,250 1
2008 annual bonus = 23,625 *(as in (i) above)*
Total IIT on employment income: 3,010 + 28,250 + 23,625 = 54,885 0·5
The balance payable to the tax authorities by Mr Gu for his employment income is:
54,885 – [3,010 + 6,250 + 18,250 + 23,625] = 3,750 0·5

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(iii) Translator income: 15,000 x (1 – 20%) x 20% = 2,400 1
Publication income: [60,000 ÷ (1 – 20%) x (1 – 20%)] x 20% x (1 – 30%) = 8,400 2
Tax paid abroad: 60,000 ÷ (1 – 20%) x 20% = 15,000 1
Since the tax paid abroad is higher than the tax due in China, Mr Gu does not need to pay further tax on his publishing income. 1
Sale of antique: (1,500,000 – 780,000) x 20% = 144,000 1

6

Marks

(b) An individual is regarded as a PRC resident taxpayer if he/she either:

(1) has his/her domicile in the PRC; or
(2) has no domicile in the PRC, but has resided in the PRC for one year. 1

An individual is deemed to have a domicile in the PRC if he/she habitually resides in the PRC due to registered native place, family ties or economic relationships. 1·5

'Residing for one year in the PRC' means residing in the PRC for 365 days in a calendar year. Absence out of the PRC for a consecutive period of not more than 30 days in a single trip, or absence over a number of trips with an aggregate period of not more than 90 days within the same calendar year, are treated as 'temporary absences' and are disregarded. 2·5

An individual is qualified as a non-resident taxpayer if he/she satisfies either of the following conditions:

(1) he/she has no domicile and did not reside in the PRC; or
(2) has no domicile and resided in the PRC for less than one year. 1

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3 (a) For alternative (1) the new company will be subject to value added tax (VAT). The VAT payable in each period is: output tax minus input tax for the period. 1·5

Output tax equals the sales value x 17% and the sales value includes services charges, packaging charges and freight charges. However any disbursement of freight charges should be excluded where a freight invoice is issued by the transportation company to the purchaser and the same invoice is given by the tax payer to the purchaser. 2

Input tax equals the VAT paid by the new company when it purchased the chemicals sold and on any other expenses incurred and on any fixed assets purchased for use in the business. 1

For alternative (2) the whole amount of commission received is subject to business tax (BT). The amount chargeable will normally be the full amount of the consideration received from the suppliers, as no deductions are tax allowable. 1·5

Thus, BT payable will equal commission x 5%. 1

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(b) (i) The above arrangement is called a 'purchase of goods on a commission basis' 1

Three conditions must apply:

– the consignee (Company X) does not provide finance to the consignor (its customers);
– the sellers (the suppliers) issue VAT invoices in the name of the customers; and
– the consignee (Company X) receives the commission and the consideration plus VAT paid on behalf of its customers from its customers. 3

If all three conditions are satisfied, only the commission income of Company X will be subject to BT at the rate of 5%. 1

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(ii) The tax bureau may assess the BT liability on a deemed income basis, with the income determined according to the following methods, applied in the order listed: 1

(1) The average prices of similar services provided by the taxpayer in the same month.
(2) The average price of similar services recently provided by the taxpayer.
(3) The composite taxable value, calculated by the formula: A x (1 + B)/(1 – C)
where: A = cost of business operation;
B = profits ratio (as determined by the tax bureau); and
C = applicable business tax rate. 3

4

Marks

(c) (1) 10 October. This is a sale settled on credit and the consumption tax (CT) liability arises on the date on which the funds are receivable under the sales agreement. 1·5

(2) 18 September. This is the normal case, where CT liability arises at the time of the sale of the goods. 1

(3) 21 September. This is a sale settled in advance and the CT liability arises on the date the goods are shipped. 1·5

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4 **(a)** The general principle used is that the composite value includes all the costs incurred to bring the goods to any port of China, including packaging charges, freight charges, insurance premiums, etc. 1

Based on this principle the following will be included in the composite value of the production line:

– ocean freight;
– ocean insurance premium; and
– agent's service fee. 1

2

(b) Customs duty and VAT payable

On importation:
Dutiable value = (6,000,000 – 300,000 + 120,000) x 6·8 = RMB39,576,000 1
Duty = 39,576,000 x 10% = RMB3,957,600 0·5
VAT payable = (39,576,000 + 3,957,600) x 17% = RMB7,400,712 1

On sale:
Output VAT = 60,000,000/(1 + 17%) x 17% = RMB8,717,949 1
VAT payable = (8,717,949 – 7,400,712) = RMB1,317,237 0·5

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(c) Enterprise income tax payable
Allowable cost/expenses: (6,000,000 + 120,000) x 6·8 + 3,957,600 + 5,000 + 20,000 = 45,598,600 2
Sales value = 60,000,000/(1 + 17%) = 51,282,051 1
EIT payable = (51,282,051 – 45,598,600) x 25% = 1,420,863 1

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(d) Customs may assess duty on the following bases, applied in the order listed:

– The transaction price of the same imported goods.
– The transaction price of similar imported goods.
– By working backwards from the sales price in the domestic market of the same/similar imported goods.
– The cost summation method.
– Any other appropriate method.

1 mark each method = 5

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5 Company E – Land appreciation tax payable

		RMB'000	Marks
Income earned from the transfer of the office building		65,000	0·5
Deductible costs in relation to the transfer			
Land use right	7,000		0·5
Real estate development cost	19,000		0·5
Interest expense (1,500 – 250)	1,250		1·5
Other property development costs allowed by the local government [(7,000 + 19,000) x 5%]	1,300		1
Tax paid in relation to the building transfer (65,000 x 5%)	3,250		1
Additional allowable deduction for property developers [(7,000 + 19,000) x 20%]	5,200		1
Total deductions		(37,000)	
Appreciation for the building transfer		28,000	
The ratio of appreciation to total deductible cost 28,000/37,000		75·67%	1
Land appreciation tax			
On the portion of appreciation less than 50% of total deductible cost (37,000 x 50%)	18,500		
– applicable tax rate	30%		
		5,550	1
On the portion of appreciation more than 50%, but less than 100% of total deductible cost (28,000 – 18,500)	9,500		
– applicable tax rate	40%		
		3,800	1
Land appreciation tax liability		9,350	

The LAT liability would have been payable by no later than 7 May 2009, i.e. within seven days of signing the contract assigning the property. 1

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